



Risk Assessed Marketing

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LRP WILL SOON INSURE HEIFERS¹

The Applied Analytics Group (AAG) who developed Livestock Risk Protection (LRP) requested a number of changes for the LRP contract and several of those changes were approved by the RMA Board. During a recent RMA Board meeting they authorized the following changes and additions to the LRP for feeder cattle, fed cattle and swine contracts beginning with the 2004 crop year: (1) approval of a procedure to apply a "factor" to adjust the insurable price of feeder cattle as necessary; (2) allow insurance for heifers, Brahma and/or dairy breeds under LRP feeder cattle coverage; (3) approval of LRP-Feeder Cattle pilot program to include 91 and 119 day periods (13 and 17 week contracts); and (4) revise the weight eligibility criteria to allow insurance for lighter weight feeder cattle that will include 400 to 900 pounds.

Most livestock producers will see these changes as major improvements to the LRP feeder cattle contract. Kansas producers will benefit most from the addition of heifers as insurable cattle. Because some Kansas producers do not background their calves, the availability of coverage for lighter weight cattle will make those producers eligible. Before the lightest insurable weight was 600 pounds but this change will allow producers to insure calves down to 400 pounds. This was a major issue in some of the Western States where it is common to sell 400-500 pound weaning calves. The basis risk is likely to be different for the lighter weight calves so producers need to be aware the LRP is only insuring against a negative price change in the Chicago Mercantile Exchange (CME) feeder steer index price located on the WEB at:

http://www.cme.com/prices/cash-settled_commodity_index_prices.cfm

The addition of dairy and Brahma breeds were not major obstacles to Kansas sales. But the elimination of these breeds was a major problem in other states. The approval for the shorter coverage of 13 and 17 weeks was interesting. The two major advantages for the LRP contract

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was the ability to purchase coverage in far out months that have very few put options with open interest and the ability to match coverage with herd size rather than a standard 50,000 pound put option. The ability for small cow herd producers (less than 500 cows) to incrementally price calves using LRP is its major advantage.

The short LRP coverage time period is not a great advantage because the nearby and the first deferred contracts have actively traded put options. This would appear to make the LRP a more direct competitor with the CME put option. While the LRP with longer coverage periods provided little competition with the put because there was little trading volume or demand for those deferred options.

It is unclear what AAG means by “a factor to adjust the insurable price of feeder cattle as necessary.” If this means AAG will be able to set the coverage at 95% of the expected price, that too will be an LRP improvement. Currently, on most days the highest coverage offered is only about 93-94.5% of the expected price.

It is unclear when these changes will be made. The Board approved these changes in crop year 2004. However, does that mean these changes will be added soon or will the changes have to wait until July 1, 2004?

These changes in the LRP contract are major improvements and should make it a better tool for calf producers. The one major remaining obstacle to LRP participation is the public policy that does not allow producers to change insurance companies if the insurance company exceeds its liability limit and can not fill a Specific Coverage Endorsement (SCE). There have been situations where producers have developed a written marketing plan. They then started to scale in the minimum price by purchasing SCE's under their LRP policy as their price objectives were met. However, in some cases they purchased one or two SCE's only to find out the insurance company had reached its liability limit and the next SCE order is not filled. Currently there is no provision to allow producers to purchase those SCE's from another company that still has capacity left. As result producers can not complete their marketing plan.

These details will be covered by Dr. Peter Griffin with AAG. Dr. Griffin is the featured speaker at the livestock/crop insurance workshop in Great Bend, Kansas on Tuesday, November 18, 2003 (Nebraska and Colorado on the following two days). More details and a program are posted at: <http://www.agmanager.info/crops/insurance/workshops/filespdf/ciwks.pdf> or call 785.532.1506.